

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Ottawa, Canada

Meeting Date: December 2-5, 2013

Agenda Item 4

For:

☒ Approval

☐ Discussion

☐ Information

Public Sector Specific Financial Instruments

Objective(s) of Agenda Item

1. The objective of the session is to approve the project brief on Public Sector Specific Financial Instruments.

Material(s) Presented

Agenda Item 4.1 Draft Project Brief, *Public Sector Specific Financial Instruments*

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

PROJECT BRIEF AND OUTLINE

1. Subject—Public Sector Specific Financial Instruments

- 1.1 This project will develop requirements and guidance on accounting for a number of public sector specific financial instruments, which are not within the scope of IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement* and IPSAS 30, *Financial Instruments: Disclosure*. IPSAS 28–30 are based on the IASB's financial instruments standards as at December 31, 2008.
- 1.2 Existing IPSASs only address accounting for two public sector specific financial instruments – concessionary loans and large scale financial guarantees in non-exchange transactions. IFRSs also do not specifically address accounting for such financial instruments, and the IASB has no project on its agenda to address these issues.¹
- 1.3 When IPSAS 28–30 were developed, the IPSASB considered these two public sector specific instruments. The IPSASB acknowledged at that time that guidance was needed to address additional public sector specific financial instruments. However, the decision was made to prioritize developing IPSAS 28–30 as an IFRS convergence project. The IPSASB signaled its intention to address further public sector specific financial instruments at a future date.
- 1.4 A number of public sector specific financial instruments have previously been identified: monetary gold, IMF special drawing rights, reserve position in the IMF and currency issued by the entity.
- 1.5 For work planning purposes this project is meant to address public sector specific financial instruments issues, however, many of the issues discussed in this project brief do not meet the definitions of a financial instrument, a financial asset and/or a financial liability in IPSAS 28.

2. Project Rationale and Objectives

- 2.1 Only a small number of national level entities will have many of the public sector specific financial instruments identified in this project. However, in such cases, these instruments are likely to be material. There is limited national and international guidance on how to account for such public sector specific financial instruments which has resulted in inconsistency in how they are accounted for. This diversity in accounting for public sector specific financial instruments is contrary to the objectives of financial reporting and the qualitative characteristics in chapters 2 and 3 of the conceptual framework.

(a) Issues identified

- 2.2 There are a number of issues that will need to be considered in this project. A brief introduction to the issues is included below:

¹ Staff is not aware of public sector specific financial instruments guidance issued by national standard setters, other than the Accounting Standards Board (South Africa), *Standard of Generally Recognized Accounting Practice: Statutory Receivables (GRAP 108)*.

2.2.1 *Monetary Gold*

- i. Monetary gold is gold owned by authorities (usually central banks or reserve banks) which is held as a reserve asset and for which there is no related liability.
- ii. Monetary gold is physical in nature and does not meet the definition of a financial instrument in IPSAS 28, because that definition requires a contract that gives rise to both a financial asset of one entity and a financial liability or equity interest of another entity. While the entity holding the monetary gold has an asset, there is not a corresponding financial liability or equity instrument held by another entity related to it.
- iii. Approaches to accounting for monetary gold vary, mainly over measurement with some entities using historical cost/deemed cost, while other entities use fair value. In practice there is also a range of methods being used when determining fair value by use of the spot rate of gold. The variability relates to which gold market spot rate is used, as well as the timing of that spot price. Further guidance in this area would be beneficial.

2.2.2 *International Monetary Fund (IMF) Special Drawing Rights (SDRs) and IMF Reserve Position*

- i. SDRs are international reserve assets, created by the IMF in 1969 to supplement IMF member countries' official reserves. The value of a unit of SDR is based on a basket of four currencies (Euro, Japanese Yen, Pound Sterling and U.S. Dollar). The U.S. dollar-equivalent value of the SDR is posted daily on the IMF's website and is calculated as the sum of the specific amounts of the four basket currencies in U.S. dollars, on the basis of exchange rates quoted at noon each day in the London market. The IMF allocates SDRs to IMF member countries based on their IMF quotas (see below). These allocations provide each member with a, unconditional international reserve asset on which interest is neither earned nor paid. However, if a member's SDR holdings rise above their allocations; it earns interest on the excess. Conversely, if a member holds fewer SDRs than allocated, it pays interest on the shortfall. The IMF cannot allocate SDRs to itself or to other prescribed holders².
- ii. Holding an SDR allocation does not guarantee they can be exchanged for cash on demand as there is still a need to find a counterparty which participates in the SDR program to agree to a transaction. These limitations and the unique nature of these instruments, including how they are granted and exchanged, as well as the contractual rights provided to their holders, raise questions as to whether they meet the definition of an asset in IPSAS 1, *Presentation of Financial Statements*, or a financial asset in IPSAS 28.
- iii. In practice, measurement of the SDR position with the IMF is based on the IMF's posted value which is, in turn, based on the underlying value of the currencies which make up the SDR unit. The possibility of alternative valuations needs to be considered.
- iv. Accounting for SDR allocations varies. Some participants recognize an asset for their SDR allocation. Others record an asset related to the SDR position and a countervailing liability (staff are not clear as to the substance of the liability).
- v. A member country's reserve position in the IMF results when the member subscribes to the initial IMF quota. Members provide resources to the IMF through payments of quotas, which are broadly based on each country's economic size. A country's quota subscription determines the

² Prescribed holder(s) is the term used for IMF designated entities which are allowed to buy/sell SDRs.

maximum amount of financial resources the country is obliged to provide the IMF. A country must pay its subscription in full upon joining the IMF (up to 25% must be paid in the IMF's own currency-SDRs or widely accepted currencies (such as the Euro, U.S. Dollar, Pound Sterling or Japanese Yen), while the remainder of the subscription is paid in a member's own currency. The main issue is whether the quota subscription to the IMF is a financial asset or an equity instrument.

- vi. A further issue is whether the reserve fund position in the IMF and SDR positions should be presented on a gross, net or linked basis.

2.2.3 *Currency and Coin in Circulation*

- i. There are two issues related to currency and coin in circulation. The first, which is not directly a financial instruments issue, is how to account for costs related to the development of new currency and coin series'; in particular whether such costs meet the definition of an intangible asset in IPSAS 31, *Intangible Assets*, and, if so, whether they meet the criteria for recognition in the statement of financial position. The second issue, which is specifically related to public sector financial instruments, is how to account for the currency and coin in circulation on the statement of financial position of the entity. Currency issued by the entity meets the definition of a financial instrument as the liability held by the entity for the currency in circulation, would give rise to a corresponding asset for the entities which hold the currency. Although, there currently is no specific guidance related to accounting for currency and coin in circulation, in practice most entities do recognize a liability for currency and/or coin issued by the entity which is in circulation. The variability in accounting practices relates to whether the entity issuing the currency and coin accounts for both currency and coin in circulation, as well as if there are any allowances made for currency and coin in circulation which may be damaged or not exchanged for future series of currency and coin. For any amount of currency and coin in circulation not all the notes/coins in a series would be expected to be exchanged if a new series is issued (and the original series has expired) or if the liability was settled (although impractical). Detailed guidance related to the considerations which should be made in determining the appropriate accounting treatment for recognition and measurement, as well as appropriate disclosures would be helpful in standardizing the accounting for these financial instruments.

2.2.4 *Concessionary Loans and Financial Guarantees Issued in Non-Exchange Transactions*

- i. Currently IPSAS 29 contains application guidance on accounting for concessionary loans. This guidance covers accounting for such loans both on inception and at subsequent reporting periods for both grantors and recipients. At inception for an entity receiving a concessionary loan, the difference between the fair value of the concessionary loan and a loan at market terms is dealt with in accordance with IPSAS 23, *Revenue in Non-Exchange Transactions (Taxes and Transfers)*. At inception an entity granting a concessionary loan recognizes the difference between the fair value of the concessionary loan and a loan at market terms as an expense in surplus or deficit. For both types of loans, subsequent re-measurement of the loans is accounted for in accordance with the financial instrument classification in IPSAS 29.
- ii. IPSAS 29 defines financial guarantees and provides detailed application guidance on how to account for financial guarantees issued in non-exchange transactions both at initial recognition and subsequently. IPSAS 29 is explicit that only contractual financial guarantees are within its

scope. The application guidance in IPSAS 29 addresses various scenarios relating to financial guarantee contracts issued in non-exchange transactions. Where consideration is present, the entity needs to determine if the consideration represents fair value. In situations where no consideration has been received or the consideration received is not at fair value, an entity needs to assess whether there are quoted prices in an active market for an equivalent guarantee. If an equivalent guarantee is identifiable in an active market, such a guarantee should be used as the basis of valuation. In the situation where there is not an equivalent guarantee and/or an active market, a valuation technique should be used. However, the entity needs to be satisfied that the output of any model is reliable and understandable. If a reliable measure of fair value cannot be determined, either by direct observation of an active market or through another valuation technique, an entity is required to apply IPSAS 19 for accounting for the financial guarantee.

- iii. For both concessionary loans and financial guarantees, consideration might be given whether the current application guidance is appropriate or if additional guidance or revisions are required.

2.2.5 *Statutory Receivables and Payables*

- i. Recently the Accounting Standards Board of South Africa (SA) released a Standard on Statutory Receivables; *Standard of Generally Recognized Accounting Practice, Statutory Receivables (GRAP 108)*. The standard explicitly does not apply to contractual arrangements which are covered by the SA financial instruments standard and receivables related to leases which fall under the SA lease accounting standard, as well any receivables related to insurance contracts. The standard notes that statutory receivables can arise as a result of both exchange and non-exchange transactions, and the applicable SA standards for exchange and non-exchange revenue (which are based on IPSAS 9 and IPSAS 23) should be applied in conjunction with the new standard on statutory receivables.
- ii. Statutory receivables are defined as receivables that: (a) arise from legislation, supporting regulations or similar means; and (b) require settlement by another entity in cash or another financial asset.³
- iii. Statutory receivables are recognized as follows:
 - a. If the transaction is an exchange transaction (use SA standard for revenue from exchange transactions—which is based on IPSAS 9);
 - b. If the transaction is a non-exchange transaction (use SA standard on taxes and transfers—which is based on IPSAS 23); or
 - c. If the transaction is not within the scope of the SA standards listed in (a) or (b) or another SA accounting standard, the receivable is recognized when the definition of an asset is met and when it is probable that the future economic benefits or service potential associated with the asset will flow to the entity and the transaction amount can be measured reliably.

³The standard applies to the recognition and measurement of statutory receivables, for which taxes and fees which have been levied, and does not deal with the ability and power to tax by an entity.

- iv. Statutory receivables are initially measured at their transaction amount, which is the amount specified in, or calculated, levied or charged in accordance with legislation and subsequently measured at cost, with cost being the transaction amount with adjustments for interest or other charges accrued on the receivable (if applicable), impairment losses and amounts derecognized.
- v. Consideration should be given to the extent to which statutory payables should be in the scope of the project.
- vi. Statutory receivables would be applicable to a broad range of public sector entities. Further, the nature of such receivables could be argued to be non-financial. Therefore, consideration should be given as to whether this type of legislated receivable should be within the scope of the project.

(b) Objectives to be Achieved

- 2.3 The ultimate objective of the project is to issue new/expanded application guidance to existing financial instruments IPSASs and/or and an additional public sector financial instruments IPSAS.
- 2.4 The intermediate objective is to produce a Consultation Paper (CP) followed by an Exposure Draft (ED). The CP will identify the public sector financial instruments issues, believed to require additional accounting guidance to that provided in IPSAS 28–30.

(c) Link to IFAC and IPSASB Strategic Plans

i. Link to IPSASB Strategy

- 2.5 One of the IPSASB's continuing strategic priorities for the period 2012–2014 is public sector critical projects. The development of requirements and guidance to address public sector financial instruments issues is a public sector specific project.

ii. Link to IFAC Strategic Plan

- 2.6 The IFAC Strategic Plan for 2011–2014 includes two strategies that are relevant. The first is IFAC's commitment to the development, adoption and implementation of international standards, including those for the public sector. The second is an enhanced focus on public sector financial reporting. Developing requirements and guidance for public sector specific financial instruments supports both strategies.

3. Outline of the Project

(a) Project Scope

- 3.1 The scope of this project is to determine the appropriate accounting treatment for the public sector specific financial instruments identified above.

(b) Key Issues

- 3.2 A number of key issues are set out below. The list is not exhaustive.

Key Issue #1—How should the IPSASB approach this project?

- 3.3 A key issue is whether additional guidance is required. As indicated above the number of entities, which have some of the public sector specific financial instruments identified in this project brief is limited⁴, generally to central/reserve banks, national ministries of finance and the whole of government accounts level. It should also be noted that currently several central/reserve banks are applying IFRS for their accounts and to account for these types of financial instruments. This raises two points for consideration. First it may be questionable, whether additional guidance in IPSAS is needed for the issues applicable only to central banks if a large number of these entities apply IFRS⁵. Second, if these issues can be dealt with under current IFRS standards appropriately is there a need for additional guidance, given IPSAS standards for financial instruments are consistent with IFRS (IPSAS are consistent with IFRS Financial Instruments Standards, as at 31 December 2008).

Key Issue #2—What is the appropriate scope of the project?

- 3.4 A key issue is the appropriate scope of the project. Do the areas identified provide a comprehensive list for the development of additional guidance? Are there further issues which should be considered, or alternatively, should the issues be reduced?

Key Issue #3—Should the goal of the project be to develop a separate public sector financial instruments IPSAS, application guidance to accompany current IPSAS 28–30 or some combination of both options?

- 3.5 A key issue will be to determine the appropriate output. Public sector financial instruments issues can be seen as a subset of financial instruments, which can be addressed by introducing further application guidance to IPSAS 28–30. Alternatively, it can be argued that the issues related to public sector specific financial instruments are outside the scope of current IPSAS 28–30 and that a separate IPSAS should be developed. A further option could be the development of application guidance in IPSAS 28–30 in combination with a separate IPSAS addressing selected issues.

Key Issue #4—Should concessionary loans and financial guarantee contracts be within the scope of the project?

- 3.6 A key issue when considering the scope of the project is whether accounting for concessionary loans and financial guarantee contracts, which are addressed in current IPSAS, should be re-visited and included within the project scope with the aim at providing additional or revised guidance. Staff is of the view that the current guidance provided in IPSAS 28–30 is sufficient and appropriate. Further, as the effective date of adoption for IPSAS 28–30 was January 1, 2013, any revisions to the standards resulting from a post-implementation review would seem premature.

4. Describe the Implications for any Specific Persons or Groups

(a) Relationship to IASB

- 4.1 This project addresses public sector specific financial instruments issues. It is not expected the IASB would have a particular interest in this project. However, it should be noted that many of the

⁴ Accounting for monetary gold, SDR allocations and reserve position in the IMF, and currency and coin in circulation, are generally limited in applicability to central or reserve banks.

⁵ Some central/reserve banks apply IFRS, however, may be required to be consolidated by other controlling entities and required to apply IPSAS or national accounting principles for this purpose.

issues covered by this project are based on issues applicable to central/reserve banks. While the accounting standards applied to central reserve/banks vary greatly around the world, there are a number of central/reserve banks which do apply IFRS.

(b) Relationship to Other Standards, Projects in Process or Planned

- 4.2 Dependent upon the outcome of this project, there may be implications for several IPSASs; most impacted would be IPSAS 28, IPSAS 29 and, IPSAS 30. Also, this project may be impacted by the Government Business Enterprise project (GBE)⁶ and the Government Finance Statistics (GFS) project. Further the IASB has an ongoing project related to financial instruments, which is expected to produce revised financial instruments pronouncements in relation to classification and measurement, impairment and hedge accounting. At this stage (November 2013), the project is still ongoing and final amendments are not known, however, the changes are not expected to fundamentally change the IASB standards to a degree which would impact the public sector specific financial instruments identified in this project brief. It should also be noted that a future project to deal with the changes in the IASB financial instruments standards has been considered by the IPSASB and a decision has been made to delay any changes to IPSAS 28–30, until the IASB project is completed.

(c) Other—Government Finance Statistics

- 4.3 The IPSASB has recently reaffirmed the importance of reducing differences with the statistical basis of reporting where appropriate with the publication of a Consultation Paper, *IPSAS and Government Finance Statistics Reporting Guidelines*. This project will consider requirements and guidance on accounting for public sector financial instruments under the statistical basis of reporting. It will assess whether there are opportunities for reducing differences in accounting treatments. The following public sector specific financial instruments issues identified by the GFS project task force will be considered:⁷

- Currency and coin issued by the entity and seigniorage;
- Subscriptions to international organizations;
- Transactions between central/reserve banks and government entities;
- Recognition of contractual guarantees (see discussion above related to this issue); and
- Other items when identified through this project or by the GFS project for further investigation as they arise.⁸

5. Development Process, Project Timetable and Project Output

(a) Development Process

- 5.1 The development of outputs will be subject to the IPSASB's formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project

⁶ Based on research performed it would seem that many central/reserve banks would be GBE's as defined in IPSAS. Therefore, any changes to IPSAS as a result of the GBE project may have an impact on this project.

⁷ Issues identified by the GFS task force related to IPSAS 28–30, will be dealt through a future project to revise and update those standards.

⁸ The GFS project is ongoing and the task force and staff continue to identify areas for convergence.

progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

(b) Project timetable

Major Project Milestones	Expected Completion
Present draft Project Brief	December 2013
Initial discussion of issues	December 2013
Undertake further research on types of public sector financial instruments (December 2013–June 2014)	
Discussion of issues and development of a CP (June 2014–December 2014)	
Approve CP (4 month comment period)	December 2014
Review of responses to CP and development of an ED (June 2015–December 2015)	
Approve ED (4 month comment period)	December 2015
Review of responses to ED and development of a IPSAS	
Approve Final IPSAS	Late 2016/Early 2017

(c) Project output

- 5.2 The initial output will be a CP. Following analysis of the responses to the CP an ED will be developed. The ultimate output will be additional application guidance to IPSASs 28–30 or a new IPSAS.

6. Resources Required

(a) Task Based Group/Task Force

- 6.1 A Task Based Group/Task Force will assist in providing information on the broad range of public sector specific financial instruments issues, to evaluate accounting options and to oversee the project. Given the complexity and limited application of some of the issues identified it is thought that adding 1 or 2 outside individuals with specific expertise to the task based group to create a task force would be beneficial.⁹

(b) Staff

- 6.2 It is envisaged that 0.5 Full Time Equivalent (FTE) will be required to resource the project.

(c) Factors that might add to complexity and length

- 6.3 Factors that might add to the complexity and length of the project include:

⁹ Staff view is that it would be useful to include in the task force a person with specific expertise in accounting for IMF SDR allocations and reserve position, as well as a person with experience dealing with accounting for public sector specific financial instruments in a central/reserve bank.

- 6.3.1 The wide range and diversity of issues and practices in regards to financial instruments in the public sector, as well as the small number of entities for which some of the issues¹⁰ are actually applicable makes sourcing literature on current accounting rules, guidelines and policies challenging;
- 6.3.2 The interaction between this project and the development of the Conceptual Framework; and
- 6.3.3 The continuing development and modification of financial instruments accounting standards by the IASB. Radical changes in financial instruments standards by the IASB could have an impact on the approach taken by the IPSASB to public sector specific issues, although, as indicated above, any changes are not expected to have a fundamental Impact.

7. Important Sources of Information

- 7.1 Potential sources of information on public sector financial instruments include:
 - 7.1.1 The Financial Statements of various governments and central banks/reserve banks.
 - 7.1.2 Accounting Standards Board (South Africa). Standard of Generally Recognized Accounting Practice: Statutory Receivables (GRAP 108).
 - 7.1.3 The Government Finance Statistics Manual (2001) (revision expected shortly).
 - 7.1.4 The System of National Accounts (SNA) 2008.
 - 7.1.5 European System of Accounts.

¹⁰ The issues of monetary gold, SDR allocations and reserve position in the IMF, and currency and coin in circulation, are generally applicable to central banks only.